

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA LAWFUL GAMBLING CONTROL BOARD

In the Matter of the  
Manufacturer's License of  
Muncie Novelty, Inc.

RECOMMENDED CONCLUSIONS  
AND ORDER ON MOTION FOR  
SUMMARY DISPOSITION

The above-entitled matter is before the undersigned Administrative Law Judge on the parties' cross-motions for Summary Disposition.

Richard Kammen, Attorney at Law, 235 North Delaware, Indianapolis, Indiana 46204 appeared on behalf of the Licensee, Muncie Novelty, Inc. Kevin P. Staunton, Special Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101 appeared on behalf of the Minnesota Lawful Gambling Control Board (hereinafter "the Board"). The record closed on these cross-motions on December 24, 1990, upon receipt of the final submission from the parties.

Based on the record herein, and the arguments of counsel, the Administrative Law Judge respectfully recommends that the Board make the following:

CONCLUSIONS

1. The Lawful Gambling Control Board has the authority under Minn. Stat. 349.163, subp. 4 and 349.2122 to require disclosure, without a warrant, of all the books and records of gambling equipment manufacturers who hold licenses from the Board.
2. Muncie Novelty Company, Inc. violated Minn. Stat. 349.163, subp. 4 and 349.2122 when it refused to disclose records of sales transactions involving gambling equipment sold in states bordering Minnesota upon the reasonable request of the Board's agents.

Based on the foregoing Conclusions, the Administrative Law Judge respectfully recommends that the Board make the following:

ORDER

1. The Licensee's Motion for Partial Summary Disposition is DENIED.
2. The Board's Motion for Partial Summary Disposition is GRANTED.

Dated: January 16 1991.

PETER C. ERICKSON

Administrative Law Judge

#### NOTICE

This Report is a recommendation, not a final decision. The Board will make the final decision after a review of the record which may adopt, reject, or modify the Recommended Conclusions and Order herein. Pursuant to Minn. Stat. 14.61, the final decision of the Board shall not be made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by these Recommended Conclusions and Order to file exceptions and present argument to the Board. Parties should contact Thomas Anzelc, Director, Minnesota Lawful Gambling Control Board, 10 River Park Plaza, St. Paul, Minnesota 55146, to ascertain the procedure for filing exceptions or presenting argument.

Pursuant to Minn. Stat. 14.62, subd. 1, the Board is required to serve its final decision on the Administrative Law Judge by first class mail.

#### MEMORANDUM

Muncie Novelty, Inc. (Muncie) has held a license from the Minnesota Lawful Gambling Control Board (the Board) to manufacture gambling equipment for distribution in Minnesota. Pursuant to its own authority, and acting for the Board, the Special Taxes Division of the Minnesota Department of Revenue (the Department) notified Muncie that the Department wished to inspect "all of your books and records regarding sales, shipments and deliveries of gambling equipment to, or for use in, the states of Minnesota, Wisconsin, Iowa, South Dakota, and North Dakota during the period January 1, 1989, through April 30, 1990." Respondent's Exhibit B. The letter containing the foregoing notice also advised Muncie that the inspection would be held during regular business hours on May 15 through 19, 1990, at the business offices and manufacturing plant of the company. Muncie was advised that the failure to comply with the request of the Department would result in a recommendation to the Board that Muncie's manufacturer's license not be renewed. On May 17, 1990, through its representative, Robert Broyles, Muncie refused to permit agents of the Department to inspect the books and records of transactions in any state other than Minnesota. As a result of that refusal, the Department recommended to the Board that Muncie's manufacturer's license not be renewed.

Muncie maintains that the Board lacks the statutory authority to compel the disclosure of books and records of transactions other than those involving Minnesota customers. The Board argues that it has broad authority to inspect the records sought through the express language of the statutes governing inspections of licensed manufacturers of gambling equipment. Both parties have moved for summary disposition.

Summary judgment is appropriate where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *SAuter v. Sauter*, 70 N.W.2d 351, 353 (Minn. 1955); *Louwagie v. Witco Chemical Corp.*, 378 N.W.2d 63, 66 (Minn.App. 1985).

Summary disposition is the administrative equivalent to summary judgment and the same standards apply. Minn. Rule 1400.8606, subp. 3(I). Greater Duluth COACT-v.. City-of Duluth, 701 F.Supp. 1452, 1457 (D.Minn. 1988) requires that decisions on license renewals be based upon findings and conclusions. Since the facts in this case are undisputed, no findings are needed to comply with Greater Duluth COACT. The issues argued and which require conclusions are whether the Board has the statutory authority to compel inspection of records of sales transactions to customers in other states than Minnesota, and whether Muncie's conduct violated Minn. Stat. 349.163, subd. 4 and 349.2122.

Two statutes are cited by the parties regarding authority to conduct inspections of books and records. Minn. Stat. 349.163, subd. 4 states:

Subd. 4. Inspection of manufacturers

Employees of the division and the division of gambling enforcement may inspect the books, records, inventory, and business premises of a licensed manufacturer without notice during the normal business hours of the manufacturer.

The other statute, Minn. Stat. 349.2122 states:

A manufacturer licensed with the board who sells pull-tabs and tipboards to a distributor licensed by the board must file with the commissioner of revenue, on a form prescribed by the commissioner, a report of pull-tabs and tipboards sold to licensed distributors. The report must be filed monthly on or before the 25th day of the month in which the sale was made. The commissioner of revenue may inspect the books, records, and inventory of a licensed manufacturer without notice during the normal business hours of the manufacturer. Any person violating this section shall be guilty of a misdemeanor.

Neither statute expressly limits the authority of the Board or the Department to examine only books or records of sales transactions with Minnesota customers.

Muncie asserts that the statutes must be read *In pari materia* to determine the legislative intent behind the statutory provisions. The thrust of that argument is that the monthly report requirement of Minn. Stat. 349.2122 shows a legislative intent contrary to the Department's claimed authority. Muncie claims that only the books and records which provide the information in each report can be inspected by the Department.

Statutes which govern the same subject matter are *in pari materia* and should be read together to determine legislative intent. *Foley v, Whelan*, 17 N.W.2d 367, 369 (Minn. 1945). In this case, the regulation of lawful gambling begins at Minn. Stat. 349.11. That statute states:

The purpose of sections 349.11 to 349.22 is to regulate lawful gambling to prevent its commercialization, to insure integrity of operations, and to provide for the use of net profits only for lawful purposes.

Minn. Stat. 349.11. To achieve those ends, the Legislature has

regulated every aspect of lawful gambling in Minnesota. A system of licensure was established to restrict who may conduct gambling operations. The details of manufacturing gambling equipment are minutely specified by rules promulgated under the Board's authority. Periodic reporting is required of licensees. Violations of these statutory provisions were made criminal offenses.

The Board was created by Minn. Stat. 349.151 as part of the scheme to regulate lawful gambling. Among its powers and duties, the Board may "receive reports required by this chapter and inspect all premises, records, books, and other documents of organizations, distributors, manufacturers, and bingo halls to insure compliance with all applicable laws and rules." Minn. Stat. 349.151, subd. 4(4). This statutory grant of authority gives the Board the general authority to inspect books and records for the purpose of exercising its licensing power. No limitation is put upon the scope of the books and records subject to inspection. Although reports are mentioned in that item, the intent of the Legislature clearly relates the inspection authority to compliance with applicable statutes. The statutory grant of authority, whether found at Minn. Stat. 349.151, subd. 4(4), 349.163, subd. 4, or 349.2122 places no restriction on the scope of the books and records which may be inspected. Reading these statutory provisions together reinforces the conclusion that the Legislature intended that all the books and records of licensees are to be open to the Board when it carries out its inspections.

Muncie has raised the issue, albeit indirectly, of whether the Board is entitled to inspect all of its books and records absent any reasonable suspicion of illegal activity. Put another way, can the Board conduct a search of a manufacturer's premises, books, and records without probable cause? Ordinarily, a warrant (obtained through a showing of probable cause) is required to search business premises. *Set-v. Seattle*, 387 U.S. 307 (1978). If a business is "pervasively regulated" warrantless searches are permissible. *U.S. v. Biswell*, 406 U.S. 311 (1972); see also *Marshall v. Barlow's, Inc.* 436 U.S. 307, 313 (1978) (OSHA not "pervasive regulation"); see generally G. Beck, L. Backen, & T. Muck, *Minnesota Administrative Procedure*, 3.4.1 (1987). Similarly, if an industry is "Closely regulated" and "long subject to close supervision and inspection," warrantless searches are permitted. *Colonnade Catering Corp. v. U.S.*, 397 U.S. 72, 74-77 (1970).

In this case, the industry is gambling and the business is the manufacture of gambling equipment. Gambling in Minnesota has been either prohibited or regulated throughout this century. Statutes of Minnesota 6588-6590 (1894) (prohibiting gambling); Minn. Stat. 614.053-.06 (1945) (gambling prohibited except for bingo permitted under specified circumstances); Minn. Stat. Chapter 349 (1963) (established system of regulation to reduce commercialization of bingo). As discussed above, every aspect of lawful gambling is controlled, either by statute or rule. Only licensees can manufacture gambling equipment. Violations of the statute or rules governing such manufacture or the related reporting requirements constitute crimes ranging from misdemeanors to felonies. Minn. Stat. 349.2127 and 349.22.

The factors to determine whether an industry is pervasively regulated were considered in *New York v. Burger*, 482 U.S. 691, 704-05 (1987). The Supreme Court examined the extent of the activity's regulation, whether a license was required, whether records were required to be maintained, whether records were required to be available for inspection, whether a registration (or number) was required to be displayed at the place of business, and whether criminal penalties are imposed for violations of the regulatory scheme. *Burger*, 482 U.S. at 703-05. The history of regulation was also considered to be relevant to the issue of whether the industry is closely regulated. *id.* at 705. Applying those factors to the facts in this case, the Administrative Law Judge concludes that manufacture of gambling equipment is a pervasively regulated business in Minnesota. This business falls within the purview of lawful gambling which has a long history of close scrutiny in this state.

Concluding that no warrant is required to conduct the inspection (search) sought herein does not end the inquiry, however. The search itself must be reasonable under the statutory scheme. *Donovan v.-Dewey*, 452 U.S. 594, 599 (1981). Three factors must be present for warrantless searches to be held reasonable. First, a substantial government interest compelling the regulatory scheme which includes the challenged inspection must exist. Second, warrantless inspections must be necessary to further the regulatory scheme. Third, the inspections authorized by the statute must provide constitutionally adequate substitutes for a warrant. *New York v. Burger*, 482 U.S. 691, 702-04 (1987).

The substantial government interest in warrantless searches of the premises, books, and records of manufacturers is shown by Minn. Stat. 349.151, subd. 4(a)(16). That provision authorizes the Board "to take all necessary steps to ensure the integrity of and public confidence in lawful gambling." The close regulation of gambling arises from the high potential for abuse and fraud in the conduct of gambling operations. Preventing such problems is a legitimate and substantial government interest.

Warrantless searches provide the means to reduce the opportunity for abuse by licensees. To rely upon probable cause to inspect is to invite abuse. To prevent prior disclosure of winning gambling equipment (and thereby eliminate an unfair advantage in play), information on the manufacturing process is restricted by law. Minn. Rule 7860.0300(C). This very protection renders information of abuse difficult to obtain. Without such information, probable cause to inspect cannot be shown. Inspections must be afforded at every point in the manufacturing and accounting process to ensure public confidence in lawful gambling. Ensuring proper payment of the taxes levied on gambling equipment requires access to the books and records of manufacturers, including those records of shipments to customers in states bordering Minnesota. These taxes are not necessarily those paid by the manufacturer, but may include taxes required of distributors. Warrantless searches are necessary to carry out the regulatory functions of the Board.

In providing an adequate substitute for a warrant, the statute must provide notice that the licensee is subject to a search and limit the discretion of the inspecting officers. *Burger*, 482 U.S. at 703. The

three statutory references to inspections quoted above inform all manufacturers that All books and records are subject to inspection. This advisory has been held sufficient for providing notice to licensees. in\* Nevada Gaming Commission v. Consolidated Casinos Corp., 575 P.2d 1337, 1338 (Nev. 1978); I,, also In Re Martin, 447 A-2d 1290, 1300 (N.J. 1982)("any records"). Regarding the discretion of investigating officers, Minn. Stat. 349.163, subd. 4 sets time, place, and scope limitations on the inspection which may be conducted of a manufacturer's business. The inspection may take place only during normal business hours. It may be located only on the manufacturer's business premises. The books, records, and inventory are the only things which may be inspected. The statute specifically provides that no prior notice need be given before the inspection. These limitations provide adequate restrictions on discretion to render the statutory system an adequate substitute for a warrant.

Applying the factors in Burger, the warrantless search undertaken in this case furthers a substantial government interest, is necessary, and was conducted under a statute which provides adequate substitutes for the protections of a warrant. The date and time of the inspection was disclosed to Muncie well in advance of the inspection. The location and scope of the inspection was clearly defined in the notice. The identities of the Department's agents were disclosed. No force was used in carrying out the inspection. When the information was not made available to the agents, the inspection was concluded. The search conducted by the Department was reasonable and authorized by Minn. Stat. 349.163, subd. 4, and 349.2122.

Muncie asserts that the Department's authority to inspect is based on the territorial limitations of Minnesota's taxation power. By this reasoning, the inspection carried out must be limited to records of Minnesota transactions. This argument does not address the delegation of authority to carry out compliance inspections from the Board to the Department and its investigators, however. The Board has not alleged or implied that Muncie has engaged in tax evasion or any violation of statute or rule other than failure to permit the inspection of records of transactions with customers in states bordering Minnesota. The obligation to comply with such inspection requests does not arise from Minnesota's taxation authority, but rather from Minnesota's authority to license manufacturers of gambling equipment.

Minn. Stat. 290.371 is cited by Muncie as a reasonable means for requiring information from manufacturers, rather than providing for warrantless searches. A report is required under that statute if a corporation, not otherwise exempt, conducts business within Minnesota before the end of its accounting period. Minn. Stat. 290.371, subd. 1. Failure to file that report precludes that corporation from redress in Minnesota courts until any tax liability is paid. Minn. Stat. 290.371, subd. 4. This statute is solely concerned with the collection of taxes from businesses which do not regularly do business in Minnesota, however. Any business with a certificate of authority to do business in this state is exempt from filing this report. Minn. Stat. 290.371, subd. 2(1). This statute does not address any of the legitimate governmental interests in regulating the lawful gambling industry.

The Board has promulgated rules to carry out its statutory responsibilities. Part of the following rule authorizes the examination of books and records:

The board and its agents may examine or cause to be examined the books and records of any manufacturer to the extent the books and records relate to any transaction connected to the sale of gambling equipment in this state, and no manufacturer shall prohibit, interfere with, or otherwise impede the examination, but shall cooperate and assist with the examination, and provide the information required.

Minn. Rule 7860.0400, subp. 8 (emphasis added). Muncie maintains that this rule limits the scope of the Board's (and thereby the Department's) search to records of only Minnesota customers. The Board maintains that the several sources of statutory authority supersede this rule. It contends that the express language of the subpart does not limit the scope of a search to books and records of Minnesota customers; rather, the rule focuses on "transactions connected to the sale of gambling equipment in this state. . . ." Minn. Rule 7860.0040, subp. 8.

Examining records of transactions with customers in states bordering Minnesota is an investigative tool for detecting illegal sales of gambling equipment in Minnesota. Deposition of Gregory Price, at 32 and 47. The Board has the authority to request manufacturer's records from other states, so long as those records also relate to transactions connected to the sale of gambling equipment in this state. Tracing gambling equipment to border states where it may be entering Minnesota for illegal sale is related in the fashion contemplated by Minn. Rule 7860.0400, subp. 8. That rule authorizes the type of search conducted in this case.

Having resolved the issue of statutory authority, the only remaining issue in this matter is whether Muncie Novelty Company, Inc. violated Minn. Stat. 349.163, subd. 4 and 349.2122. The facts in this matter are undisputed that Muncie refused to permit the inspection of its records relating to sales of gambling equipment in states bordering Minnesota. On the basis of the foregoing Memorandum the Administrative Law Judge concludes that Muncie violated Minn. Stat. 349.163, subd. 4 and 349.2122 by refusing to grant access to its books and records upon the reasonable request of agents of the Board and Department.

P.C.E.